ANNEX 3: A CURSORY COMPARISON OF BULGARIAN BANKING AND FINANCIAL INDICATORS WITH ROMANIA AND POLAND

I. Introductory Country Profiles

I. Introductory Country Profiles	1992	1995	1996	1997	1998	1999	2000
Bulgaria							
Nominal GDP (leva millions)	201	880	1,749	17,055	21,577	22,515	25,587
GDP (millions $)	8,204	13,105	9,831	10,146	12,255	12,404	12,057
GDP per capita ($)	967	1,564	1,179	1,225	1,489	1,513	1,470
Romania							
Nominal GDP (lei billions)	6,029	72,136	108,920	250,480	368,345	521,735	770,000
GDP (millions $)	13,107	27,981	26,994	31,220	33,636	28,580	
GDP per capita ($)	575	1,233	1,194	1,381	1,495	1,276	
Poland							
Nominal GDP (zloty millions)	114,944	288,700	362,800	445,100	549,500	611,600	705,856
GDP (millions $)	71,840	116,977	126,169	126,521	156,821	147,434	
GDP per capita ($)	1,871	3,031	3,269	3,269	4,052	3,810	

COMMENTARY: Bulgaria's overall GDP is smaller than Romania's and Poland's, although the difference in population sizes reflects part of this output differential. GDP per capita varies slightly and favorably when compared with Romania, but clearly is less than the rising per capita incomes registered in Poland. The latter trend has been evident since the mid-1990s, and may reflect the consequences of slow approaches to reform in the first half of the 1990s in Bulgaria and Romania, as opposed to Poland's "shock therapy" and subsequent adjustment after the very early part of the decade. This is partly borne out in the study by Fischer and Sahay ("Taking Stock", *Finance & Development*, September 2000) which shows that Poland's ratio of 1999 output to output recorded one year before the transition began (around 1989) was 28 percent higher, in contrast to these figures being 26 percent lower in Bulgaria and 20 percent lower in Romania. In particular, Bulgaria experienced its lowest growth in 1997, in contrast to Romania and Poland, whose low points were recorded in 1991-92. In Romania's case, it has been slow to reform, whereas Poland has been fairly active with economic reform for nearly a decade. Bulgaria's increase in per capita incomes since the currency board would suggest its approach to reform since 1996-97 has been more effective than what has been accomplished in Romania. However, the amount of time it has taken Poland to achieve favorable indicators also suggests that Bulgaria still requires additional time for reforms to become fully effective and to translate into materially rising purchasing power for the vast majority of its citizens.

II. EBRD Measures (from the 2000 *Transition* Report)

II. EBRD Measures (2000 Transition Report)	Bulgaria	Romania	Poland
Banking Reform & Interest Rate Liberalization	3	3-	3+
Securities Markets & Non-Bank Financial Institutions	2	2	4-
Commercial Law: Extensiveness	4	3+	4-
Commercial Law: Effectiveness	4-	4-	4
Financial Regulations: Extensiveness	3	4	4
Financial Regulations: Effectiveness	2+	3	4

COMMENTARY: Based on EBRD evaluation criteria—these are on a scale of 1 to 4, with "1" being inadequate, "2" being limited in scope and effectiveness, "3" being adequate but in need of refinement and improvement, and "4" being comprehensive, effective, and generally consistent with standards applied in advanced economies—all three countries are roughly equivalent in terms of bank solvency, the framework for banking supervision, interest rate liberalization and preferential (mandated, soft or otherwise) lending, and the participation of private banks and private sector borrowers. The author's view is that this is not correct, and that Poland is more advanced than the other two countries in terms of actual capacity, depth and sophistication. This is mainly because Poland addressed issues earlier on, was open to technical assistance for effective institution building (which strengthened regulatory/supervisory capacity several years in advance of what has been achieved in Bulgaria and Romania), and recognized the need to move to more market-based solutions for competitiveness. Bulgaria is still control/rules-oriented, even though it has clearly merited its rating from EBRD in terms of private participation in the banking sector with its privatization transactions in the last two years. However, Bulgaria and Romania both significantly lag Poland in meeting international standards in capital markets development, and Romania still has to privatize BCR (including what it inherited from Bancorex) and CEC (the former state savings bank). The EBRD has given broadly favorable ratings to all three countries in terms of commercial law. In the case of Bulgaria, this may apply to methodology. However, while laws may be satisfactory, enforcement, judicial understanding, precedent, and general court capacity and administration were not viewed as warranting at 4-. This may be an issue of "efficiency" vs. "effectiveness". However, the legal framework is still considered a problem in Bulgaria due to civil code procedures, weak capacity and training, and corruption and manipulation. Poland and Romania are also reported to have problems in these areas, although Poland has recently adopted legislation that is expected to introduce modernized procedures and practices. In terms of financial regulations, Bulgaria appears to lag both Poland and Romania in terms of coverage and effectiveness of implementation, although the author believes this is not true with regard to Romania. Much of Bulgaria's rating relates to issues of the capital markets and corporate governance, although these are viewed as weak in Romania as well. In terms of effectiveness (coverage), Bulgaria is viewed to significantly lag Poland and to clearly lag Romania. Again, this is not necessarily viewed as accurate in comparison with Romania.

III. Money, Savings and Credit Indicators

III.	Money, Savings and Credit Indicators	1992	1995	1996	1997	1998	1999	2000
	Broad Money/GDP							
	Bulgaria	79.1%	66.4%	74.9%	35.3%	30.6%	32.6%	33.7%
	Romania	30.8%	25.3%	27.9%	24.8%	25.1%	25.7%	
	Poland	35.8%	36.1%	37.2%	39.6%	40.2%	43.1%	
	Year-end base Interest Rate							
	Bulgaria	49.7%	39.8%	435.0%	7.0%	5.2%	4.6%	4.7%
	Romania	70.0%	35.0%	35.0%	40.0%	35.0%	35.0%	
	Poland	>41.4%	29.0%	26.0%	28.0%	15.5%	16.5%	
	Nominal Short-term Credit Rates							
	Bulgaria	64.6%	51.4%	480.8%	13.9%	13.5%	12.4%	12.2%
	Romania	47.5%	53.6%	55.6%	58.9%	62.0%	65.9%	53.5%
	Poland	39.0%	24.0%	20.5%	22.5%	15.5%	14.4%	
	Nominal One-month Time Deposit Rates							
	Bulgaria	45.3%	25.3%	211.8%	3.0%	3.3%	3.2%	3.3%
	Romania	32.4%	38.9%	34.1%	42.3%	41.3%	45.4%	32.7%
	Poland	32.0%	19.5%	17.0%	18.0%	11.0%	7.5%	
	Net Spreads on Nominal Bank Rates							
	Bulgaria	19.3%	26.1%	269.0%	10.9%	10.2%	9.2%	8.9%
	Romania	15.1%	14.7%	21.5%	16.6%	20.7%	20.4%	20.8%
	Poland	7.0%	4.5%	3.5%	4.5%	4.5%	6.9%	

COMMENTARY: Broad money has begun to increase in Bulgaria as a percent of GDP after collapsing in 1996-97. The steady rise with stabilization is similar to trends in Poland, which has also shown a gradual and increasing rise as real GDP growth has been sustained, confidence in banking institutions increases, and banks expand with retail and corporate services. Meanwhile, Romania's trends are less favorable, indicating less confidence in the banks and the economy. However, trends in Bulgaria should not be oversold. Broad money-to-GDP is still less than half the level achieved through 1996, and they remain very low by developed market standards. Even when compared with other EU accession candidate countries, Bulgaria lags most (apart from Latvia, Lithuania and Romania). Year-end base rates have shown considerable advantage in Bulgaria as a benefit derived from macroeconomic stabilization, having declined dramatically. Bulgaria's rates are lower than in Poland and Romania. However, low interest rates alone are not sufficient to energize an economy, as shown in Japan. Net spreads on nominal bank rates show Bulgaria approaching Poland in the narrowing of spreads, partly due to intensified competition in the corporate sector. These rates have been fairly steady since 1997, and shown very slight declines each year since then, including in 2000. However, unlike Poland, Bulgarian banks are paying negative real rates on deposits. This does not bode well for deposit mobilization efforts, although this should be corrected in the coming years as Bulgarian banks compete for a larger share of a growing consumer markets, and to expand their retail base of funding. Meanwhile, net spreads remain very high in Romania, more than double those in Bulgaria. Poland's net spreads are lower than in Bulgaria, but the gap is about 2 percent, far less than the gap relative to Romania.

IV. Macroeconomic Performance Indicators

IV. Macroeconomic Performance Indicators	1992	1995	1996	1997	1998	1999	2000
Real GDP							
Bulgaria	-7.3%	2.1%	-10.9%	-6.9%	3.5%	2.4%	5.6%
Romania	-8.8%	7.1%	3.9%	-6.1%	-5.4%	-3.2%	1.5%
Poland	2.6%	7.0%	6.1%	6.9%	4.8%	4.1%	5.0%
Total CEE and Baltics	-3.2%	5.4%	4.1%	3.6%	2.6%	2.1%	4.1%
Inflation Rate							
Bulgaria	82.0%	62.0%	123.0%	1082.0%	22.2%	0.7%	11.4%
Romania	210.0%	32.3%	38.8%	154.0%	59.1%	45.8%	45.0%
Poland	43.0%	27.8%	19.9%	14.9%	11.8%	7.3%	9.9%
Total CEE and Baltics (unweighted average)	476.0%	23.3%	24.1%	105.0%	13.7%	7.1%	9.1%
Fiscal Balance/GDP							
Bulgaria	-2.9%	-5.7%	-10.4%	-2.1%	0.9%	-0.9%	0.4%
Romania	-4.6%	-2.5%	-3.9%	-4.6%	-5.0%	-3.5%	-4.0%
Poland	-4.9%	-3.1%	-3.3%	-3.1%	-3.2%	-3.3%	-3.0%
Total CEE and Baltics	-7.1%	-3.2%	-3.7%	-3.0%	-3.1%	-4.3%	-3.3%
Current Account Balance/GDP							
Bulgaria	-4.2%	-0.2%	0.2%	4.2%	-0.5%	-5.5%	-5.8%
Romania	-8.0%	-6.3%	-8.9%	-6.8%	-7.0%	-3.8%	-4.9%
Poland	1.1%	4.5%	-1.0%	-3.2%	-4.4%	-7.6%	-7.1%
Total CEE and Baltics	-8.6%	-3.3%	-5.9%	-6.4%	-6.4%	-6.1%	-5.8%
Net Foreign Direct Investment (US$ millions)							
Bulgaria	42	98	138	507	537	806	975
Romania	73	417	415	1,267	2,079	949	500
Poland	284	1,134	2,741	3,041	4,966	6,642	10,000
Total CEE and Baltics	3,098	9,673	8,202	9,500	15,198	18,086	22,787

COMMENTARY: Bulgaria's macroeconomic fundamentals have improved since 1997 in most cases. Real GDP has increased for three years, and has exceeded the average for CEE and the Baltic states (the non-CIS transition countries) for those three years. While Bulgaria's figures have not been as impressive as Poland's long running real GDP growth rates, it has performed better than Romania in recent years. Bulgaria's real GDP growth in 2000 also exceeded Poland's for the first time in a decade. The inflation rate increased in 2000, as it did just about everywhere in the region, but has come down from hyperinflationary levels in 1996-early 1997. Nevertheless, Bulgaria experienced double-digit inflation, and this was higher than the norm for the region by 2.3 percent. Efforts to bring this rate down may have a dampening effect on economic growth. Moreover, given Bulgaria's previous years' performance, there has been little consistency with regard to inflation rates. This volatility can serve as a disincentive to investment, notwithstanding the leva link to the Euro through the currency board arrangement. Fiscal deficits have been brought under control with strict discipline, and performance on this front has been about the best in the region. There is a possibility of some fiscal loosening with the new government's proposal to increase public sector wages and pensions, and if there is a tightening of monetary policy to rein in the inflation rate. However, overall, Bulgaria has shown a high level of fiscal discipline in recent years. The statistics suggest there may be some room for such loosening on the condition that efforts continue to broaden the fiscal base and to stimulate job-creating investment. While current account deficits have increased since 1999, they remain on par with the region as countries re-tool to be more competitive. As an example, Poland (a first-tier EU accession candidate) experienced current account deficits exceeding 7 percent the last two years. Bulgaria's deficits have likewise been high, averaging nearly 6 percent over the last two years. By traditional measures, these are fairly high figures that will need to be monitored. However, much of the import bill is expected to translate into higher productivity and export earnings. As for foreign direct investment, Bulgaria remains small as a percentage of the regional total, and far less than Poland and Romania. However, Bulgaria's trends are favorable, having achieved nearly $1 billion in FDI in 2000. Plans to improve the business environment and develop the high tech sector should help in this regard. Overall, Bulgaria's macroeconomic indicators are broadly favorable, and generally in line with or outperforming regional standards.

V. Bank Ownership Profile

V. Bank Ownership Profile	1992	1995	1996	1997	1998	1999	2000
Number of Banks							
Bulgaria	79	41	42	28	33	35	35
Romania		24	31	33	36	34	
Poland		81	81	83	83	77	
Foreign-owned Banks							
Bulgaria	0	3	3	7			>20
Romania		6	8	13	16	19	
Poland		18	25	29	31	39	
Asset Share of State Banks							
Bulgaria			82.2%	66.0%			20.0%
Romania		84.3%	80.9%	80.0%	75.3%	50.3%	
Poland		71.7%	69.8%	51.6%	48.0%	25.0%	

COMMENTARY: Bulgaria experienced regulatory-driven consolidation during the early 1990s, ultimately facing a crisis in the mid-1990s in which about one third of banks had to be closed down. The remaining banks had to be privatized to restore the system's ability to function under stable conditions. Bulgaria has essentially reached that point on the basis of solvency and liquidity ratios. Bulgaria has also achieved major success with the privatization of banks via strategic foreign investment, a policy pursued in the region by Hungary, and subsequently adopted by Poland, the Czech and Slovak Republics, Croatia, the Baltic states, and several of the countries in the Balkans. The ownership trend towards an increasingly prominent role for foreign banks shows up in the table, with more than 20 of Bulgaria's 35 banks under foreign control. This is in stark contrast to 1996, when there were only three foreign banks, and when the state controlled more than 80 percent of banking system assets. Recent year indicators are broadly consistent with Poland, which has also accelerated the role of strategic foreign investment in the banking sector in recent years, and compare favorably with ownership trends in Romania, where four state banks still account for about half of system assets. Bulgaria and Poland are very similar as well with regard to the remaining banks in state hands. In Bulgaria, there are four, of which two are the former state savings bank and the bank focused on agricultural finance. In Poland, the two large banks remaining to be privatized have traditionally been in local currency savings and agricultural finance. Romania has also recently announced the privatization of its agricultural bank, and is preparing for the privatization of one other major bank, which would leave only two other banks (including the state savings bank) under state control. The privatization of Bank Agricola would bring the total to three state banks accounting for about one third of total assets. The second privatization (that of BCR) would bring Romania's state bank share to a small portion of total system assets.

VI. Bank Lending Profile

VI. Bank Lending Profile	1992	1995	1996	1997	1998	1999	2000
Domestic Credit to Enterprises/GDP							
Bulgaria	5.5%	21.1%	35.6%	12.6%	12.7%	14.6%	16.2%
Romania			11.5%	13.7%	15.2%	10.5%	
Poland	11.4%	12.7%	15.9%	17.1%	17.6%	18.8%	
Bad Loans/Total Loans							
Bulgaria		12.6%	14.6%	12.9%			8.2%
Romania		37.9%	48.0%	56.5%	67.5%	36.6%	
Poland		23.9%	14.7%	11.5%	11.8%	14.5%	
Net Domestic Credit/GDP							
Bulgaria	85.1%	58.3%	65.9%	6.8%	6.1%	6.0%	6.2%
o/w claims on Gov't	44.3%	30.6%	51.6%	9.6%	2.4%	0.7%	1.9%
o/w claims on SOEs	67.2%	19.2%	30.0%	7.4%	4.4%	3.2%	1.6%
o/w claims on Private	9.0%	21.6%	36.9%	13.1%	12.8%	15.0%	14.6%
Romania		24.9%	28.6%	18.0%	20.0%	15.9%	
o/w claims on Gov't		2.5%	5.0%	4.4%	5.1%	5.7%	
o/w claims on SOEs		22.3%	12.1%	5.1%	3.2%	1.8%	
o/w claims on Private			11.5%	8.4%	11.7%	8.4%	
Poland		33.4%	36.2%	36.3%	36.3%	39.9%	
o/w claims on Gov't		13.6%	13.7%	11.8%	10.9%	11.0%	
o/w claims on SOEs		7.0%	6.6%	6.5%	5.7%	5.2%	
o/w claims on Private		12.7%	15.9%	18.1%	19.7%	23.8%	

COMMENTARY: Bulgaria's lending has declined since 1996 after the economic collapse. However, the amount of credit allocated to enterprises (including households in Bulgaria's case) relative to GDP is not altogether different from several countries in the region. It is lower than in Poland, which experienced increases in net lending to the real sector starting in late 1995, but is higher than in Romania. In contrast to the mid-1990s, Bulgaria's loan portfolio is now of higher quality than in the mid-1990s. Thus, while lending remains relatively low, high levels of capital (relative to risk-weighted assets) and a higher proportion of standard (performing) loans reflect increased capacity in the banking system for risk-taking. This will occur in Bulgaria, as it did in Poland, as the economy grows and competition in the banking sector heats up. These developments are favorable when compared with Romania, where bad loans have been a serious problem. Meanwhile, there has been a clear shift in lending to the private sector and away from exposures to state enterprises in all three countries. On this note, Bulgaria has provided even less financing to government and state enterprises than the other two countries. This is largely the result of the currency board arrangement and strict prudential regulations.

VII. Deposit Mobilization

VII.	Bank Deposit Mobilization	1995	1996	1997	1998	1999	2000
	Deposits						
	Bulgaria (millions of leva)	509	1,114	4,216	4,429	4,956	7,116
	o/w Demand Deposits	46	110	945	1,014	1,039	
	o/w Time/Savings Deposits/Foreign Currency	463	1,004	3,271	3,415	3,917	
	Romania (billions of lei)	14,343	24,933	52,946	81,005	116,743	127,059
	o/w Demand Deposits	3,007	5,366	8,742	9,590	11,059	9,531
	o/w Time/Savings Deposits	7,383	12,481	26,523	41,213	55,211	59,858
	o/w Foreign Currency Deposits	3,953	7,086	17,681	30,202	50,473	57,670
	Poland (millions of zlotys)	84,730	112,888	145,509	190,542	225,272	249,781
	o/w Demand Deposits	17,817	28,702	34,425	41,438	49,970	50,249
	o/w Time/Savings Deposits/Foreign Currency	66,913	84,186	111,084	149,104	175,302	199,532
	Deposits/GDP						
	Bulgaria	57.8%	63.7%	24.7%	20.5%	22.0%	27.8%
	o/w Demand Deposits	5.2%	6.3%	5.5%	4.7%	4.6%	
	o/w Time/Savings Deposits/Foreign Currency	52.6%	57.4%	19.2%	15.8%	17.4%	
	Romania	19.9%	22.9%	21.1%	22.0%	22.4%	16.5%
	o/w Demand Deposits	4.2%	4.9%	3.5%	2.6%	2.1%	1.2%
	o/w Time/Savings Deposits	10.2%	11.5%	10.6%	11.2%	10.6%	7.8%
	o/w Foreign Currency Deposits	5.5%	6.5%	7.1%	8.2%	9.7%	7.5%
	Poland	29.3%	31.1%	32.7%	34.7%	36.8%	35.4%
	o/w Demand Deposits	6.2%	7.9%	7.7%	7.5%	8.2%	7.1%
	o/w Time/Savings Deposits/Foreign Currency	23.2%	23.2%	25.0%	27.1%	28.7%	28.3%

COMMENTARY: Bulgaria has increased its deposit base since major depletion occurred in 1996-early 1997. However, deposit levels remain relatively low, as in Romania, and still significantly lag levels achieved in Poland when measured against GDP. Part of the reason for the superior performance of Poland is that banks have made a stronger effort at the retail level to attract deposits in recent years. This process is only beginning in a competitive way in Bulgaria (and has yet to really occur in Romania). However, in Bulgaria, there are reasons for optimism that deposit mobilization will increase in the coming years. These include increasing competition among banks for the developing retail/consumer market, reduced tax rates for small businesses and households (that are expected to increase compliance, broaden the base and increase revenues), and conversion to the Euro on January 1, 2002 which will serve as an incentive for people to convert their DM holdings through the banking system. However, per capita incomes are lower in Bulgaria than in Poland, and hard budget constraints have served as an incentive for households and enterprises to keep cash on hand to effect transactions. Until this changes, there may be less incentive for households and firms to place deposits with banks. Negative real rates paid on deposits also serve as a disincentive. Elsewhere (including in Poland), the market has shown responsiveness when banks have increased real rates paid on deposits. Transition countries have frequently shown that people are looking to place surplus cash in financial instruments, even simple instruments such as bank savings/time deposits.